



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

RECEIVED  
U.S. E.P.A.

2016 AUG 10 AM 9:20

ENVIR. APPEALS BOARD

AUG - 9 2016

OFFICE OF  
ENFORCEMENT AND  
COMPLIANCE ASSURANCE

**MEMORANDUM**

SUBJECT: Consent Agreement and Proposed Final Order: *In the Matter of Arctic Cat, Inc.*, Docket No. CAA-HQ-2016-7854

FROM: Susan Shinkman, Director  
Office of Civil Enforcement

TO: Environmental Appeals Board

Attached for your ratification and issuance is a Consent Agreement and proposed Final Order (CAFO) to settle the above-referenced enforcement action regarding violations of Title II of the Clean Air Act (CAA or Act), 42 U.S.C. §§ 7521-7554, particularly the prohibitions of section 203(a)(1) and (2), 42 U.S.C. § 7522(a)(1) and (2). The CAFO is enclosed herein as Attachment A.

The parties in this matter have agreed to settle all causes of action before the filing of a complaint. The Consolidated Rules of Practice allow parties to simultaneously commence and conclude a proceeding by recording the settlement terms in a consent agreement signed by the parties or their representatives. 40 C.F.R. §§ 22.13(b), 22.18(b)(2)-(3). Phillip A. Brooks, Director of the Air Enforcement Division (AED) of the Office of Civil Enforcement (OCE) of the Office of Enforcement and Compliance Assurance (OECA), signed this CAFO on behalf of the United States Environmental Protection Agency (EPA), and a representative of Arctic Cat, Inc., (Respondent), signed this CAFO on behalf of the Respondent.

This memorandum is submitted in accordance with the *Environmental Appeals Board Consent Agreement and Final Order Procedures* (January 2014 version), which provide that the OCE Director or Acting Director may transmit Consent Agreements and proposed Final Orders directly to the EAB. As discussed in this memorandum, I have determined that the Consent Agreement comports with the CAA, applicable regulations, and EPA policy and would serve the public interest. If ratified, the CAFO would assess a civil penalty of \$552,000 against Respondent for the alleged violations.

Background

Governing Law

EPA alleges that Respondent (i) manufactured and sold 29,189 all-terrain vehicles (ATVs) that were not covered by a certificate of conformity (COC) and (ii) submitted two late defect reports. The governing law for these alleged violations is detailed in the CAFO. In short, Title II of the Act establishes various standards and enforcement provisions governing emissions from motor vehicles. Section 203(a)(1) of the

Act, 42 U.S.C. § 7522(a)(1), prohibits a vehicle manufacturer from selling a new motor vehicle in the United States unless the vehicle is covered by a COC. The EPA issues COCs to vehicle manufacturers pursuant to section 206(a) of the Act, 42 U.S.C. § 7525(a), to certify that a particular class of motor vehicles conforms to applicable EPA requirements governing motor vehicle emissions. Section 203(a)(2) of the Act, 42 U.S.C. § 7522(a)(2), prohibits the failure to make certain reports required by the EPA. These provisions apply to motor vehicles designed for use on public roads, but section 213(d) of the CAA, 42 U.S.C. § 7547(d), states that the nonroad vehicle standards shall be enforced in the same manner as motor vehicle standards. The EPA has promulgated regulations at 40 C.F.R. Parts 1051 and 1068 to set standards and enforcement provisions for the recreational vehicles at issue in this proceeding.

### *Respondent*

The Respondent is Arctic Cat, Inc., (Respondent or ACAT). Respondent is a manufacturer of all-terrain vehicles (ATVs) and snowmobiles. ACAT is a corporation organized under the laws of the State of Minnesota with an office at 500 N 3rd Street, Minneapolis, Minnesota 55401.

### Violations Settled by the Consent Agreement

The violations involve the manufacture and sale of 29,189 ATVs that were not covered by certificates of conformity (COC) and the submission of two late defect reports.

EPA discovered 28,925 certification violations by issuing Information Requests to ACAT, pursuant to section 208 of the Act, 42 U.S.C. § 7542, on July 5, 2011, and June 25, 2013. Respondent responded to the Information Requests on August 16, and September 16, 2011, September 16, 2013, and February 28, 2014. ACAT's responses indicated the following:

- (a) Between May 2008 and 2012, ACAT obtained from the EPA eighteen COCs that purportedly covered its 2009 - 2013 model year (MY) 550 cubic centimeter (cc) and 950 cc electronic fuel injected ATVs. These eighteen COCs supposedly covered 28,925 ATVs.
- (b) Each of the 28,925 ATVs was equipped with seven auxiliary emission control devices (AECDs), however, ACAT failed to justify and describe any of the AECDs in the eighteen applications for the COCs.
- (c) ACAT also produced some of the ATVs with emission control module (ECM) calibration maps that differed from the calibration maps in the emission data vehicle (EDV), which is the vehicle tested in support of Respondent's applications for COCs. Consequently, the ATVs as produced and sold did not conform to the ATV tested for EPA certification.

The ECM is a primary emission control component. All the 28,925 ATVs were equipped with an ECM, which is a computer that acts as the brain of the engine control processes. The ECM collects input signals from multiple sensors of the ATV, *e.g.*, revolutions per minute, engine temperature, air temperature, throttle position, manifold pressure, and crankshaft position. Based on the input signal and the fuel map(s) and spark timing map(s) programmed into the ECM, the ECM sends output signals to control the timing of the ignition spark and the amount of fuel injected, which affects the fuel delivery and spark to each cylinder.

ACAT's changes to the ECM's calibration map(s), which caused them to differ from the EDVs' calibration maps, are a material difference (*i.e.*, one that may affect the vehicle's emissions) between the



EDV and the production vehicle.<sup>1</sup> Thus, the EPA alleges that ACAT's eighteen COCs do not cover the 28,925 ATVs. As a manufacturer who sold or introduced into United States commerce ATVs that were not covered by COCs, Respondent committed 28,925 violations of section 203(a)(1) of the CAA, 42 U.S.C. § 7522(a)(1), and 40 C.F.R. § 1068.101(a)(1).

In addition to these certification violations, on or about January 25, 2016, Respondent imported into the United States 264 MY 2017 Alterra 90 cc ATVs. On February 22, 2016, the EPA issued to Respondent a COC for the 264 MY 2017 Alterra 90 cc ATVs (engine family H3AXX.0901K2). Thus, by importing into the United States 264 MY 2017 Alterra 90 cc ATVs before obtaining a COC from the EPA, Respondent committed 264 violations of section 203(a)(1) of the CAA, 42 U.S.C. § 7522(a)(1), and 40 C.F.R. § 1068.101(a)(1).

Besides the above-described certification violations, the CAFO would resolve the alleged reporting violations described below. On November 15, 2007, Respondent submitted defect reports for two MY 2007 snowmobile engine families (EFs): 73AXY.794LE2 and 73AXY.999LE2. In general, the defect report contained the following information:

- a. Respondent's snowmobile's exhaust system overheat under certain driving conditions. In some cases, these conditions, along with backfiring, may cause melting damage to the side panel/belly pan area of the snowmobile.
- b. Respondent decided to correct the problem by lowering the exhaust temperature by adjusting certain parameters in the ECM map.

Respondent proposed to reprogram the snowmobiles' ECMs with maps developed for engine family (EF) 83AXY.794LE2 on or about March 19, 2007, and developed for EF 83AXY.999LE2 on or about May 3, 2007.

Based on the nature of the defect reports (*i.e.*, the exhaust system overheating and backfiring, and melting a side panel) and the requirement that manufacturers exercise good engineering judgment, the EPA alleges that Respondent either knew or should have known by March 19, 2007 (the date of testing of the ECM map for EF 83AXY.794LE2) and May 3, 2007 (the date of testing of the ECM map for EF 83AXY.999LE2) that the ECM maps for EFs: 73AXY.794LE2 and 73AXY.999LE2, respectively, might be defective and require recalibration to fix the exhaust system overheating problem. The EPA alleges Respondent was required to submit a defect report to the EPA within 21 days of such knowledge. Thus, the EPA alleges that the defect report was 225 days late for EF 73AXY.794LE2 and 180 days late for EF 73AXY.999LE2. The EPA alleges that the submission of two allegedly late defect reports constitutes two violations of section 203(a)(2) of the CAA, 42 U.S.C. § 7522(a)(2), and 40 C.F.R. § 1068.101(a)(2).

### Civil Penalty

In determining civil penalties, the CAA requires that the EPA consider "the gravity of the violation, the economic benefit or savings (if any) resulting from the violation, the size of the violator's business, the violator's history of compliance, action taken to remedy the violation, the effect of the penalty on the violator's ability to continue in business, and such other matters as justice may require." CAA Section 205(c)(2), 42 U.S.C. § 7524(c)(2); see also 40 C.F.R. §§ 1068.125(a)(1), (b)(1) (listing these same factors). AED uses a penalty policy that incorporates these statutory factors and calculates civil penalties

---

<sup>1</sup> In this case, despite the seven auxiliary emission control devices and a calibration map that differed from the emission data vehicle, these ATVs did not have emissions that were greater than the emissions from certified vehicles.



for specific cases. CAA Mobile Source Civil Penalty Policy – Vehicle and Engine Certification Requirements (Jan. 16, 2009) (Penalty Policy), available at [http://www2.epa.gov/sites/production/files/documents/vehicleengine-penalty-policy\\_0.pdf](http://www2.epa.gov/sites/production/files/documents/vehicleengine-penalty-policy_0.pdf).

The Penalty Policy provides for calculation of civil penalties as follows. First, the Penalty Policy requires the calculation of the *preliminary deterrence amount*. This is the sum of the *economic benefit* and the *gravity*. The economic benefit is based on the vehicle power; the rule of thumb for calculating the per-vehicle economic benefit is \$1 per unit of horsepower, but no less than \$15 per vehicle. To determine the gravity component, a base gravity figure is calculated according to horsepower, then multiplied to reflect egregiousness (using a factor of 1 for minor violations, 3.25 for moderate violations, or 6.5 for major violations), scaled down according to the number of vehicles, and adjusted to reflect business size. Second, the Penalty Policy requires the calculation of the *initial penalty target figure*. This figure is the preliminary deterrence amount, but with the gravity component adjusted to reflect the violator's degree of willfulness or negligence, degree of cooperation or non-cooperation, and history of noncompliance. Finally, the initial penalty target figure can be adjusted to account for litigation risk and other unique factors.

Reporting violations are not addressed by the Penalty Policy, but are statutory violations of the CAA subject to a per day statutory maximum civil penalty. This maximum is \$32,500 for violations committed between March 15, 2004 and January 12, 2009. See 42 U.S.C. § 7522(a)(2)(A) and § 7524(a); 40 C.F.R. § 19.4 (codifying adjustments for inflation).

Under the Consent Agreement, Respondent will pay a civil penalty of \$552,000, which is a combined penalty for the certification violations addressed by the Penalty Policy (29,189 ATVs manufactured and sold without a certificate of conformity) (\$485,000), and recordkeeping violations (\$67,000). The civil penalty comports with the CAA statutory guidelines and the Penalty Policy. The details in the following sections describe the calculation of the civil penalty for the certification violations.

For the reporting violations, AED calculated a gravity penalty of \$67,000. The Penalty Policy does not apply to these violations. In relevant part it says: “[ ] in a case involving violations that are not based on uncertified vehicles or engines, or the tampering or defeat device prohibitions, the litigation team should develop a method for calculating the gravity penalty component using the general gravity penalty considerations discussed in this Penalty Policy and in the Policy on Civil Penalties.” See Penalty Policy at 22. In all recordkeeping and reporting cases since 2011, EPA has applied between \$5000 and \$25,000 for each violation.<sup>2</sup> In this case, given the seriousness of these violations, we determined that \$13,000 was an appropriate penalty for each report. The Agency generally does not assess a per day penalty, but when it has done so, it has been in the range of \$100 per day. In this case, given the significant delay in reporting, the Agency determined that a \$100 per day penalty for each report was appropriate. For EF 73AXY.794LE2, the report was 225 days late, and for EF 73AXY.999LE2, the report was 180 days late. In sum: \$13,000 + \$13,000 + \$100 \*(225 + 180) = \$66,500 (rounded to \$67,000). This calculation accounts for both Respondent's initial failure to report the defects and the duration of time during which they continued to fail to report the defects. AED identified no facts to demonstrate any economic benefit associated with the reporting violations in this case, so the entirety of the \$67,000 penalty is a gravity-

<sup>2</sup> See e.g., Yamaha Motor Corp, Peace Industry, Hammerhead, Jonway/Shenke, American Li fan. In these cases, for each record the company failed to keep, EPA assessed a gravity-based penalty between \$5,000 - \$25,000, based on the statutory factors as follows: the extent of the missing information, the disorganization of the information, the number of vehicles involved, the risk of unlawful emissions from those vehicles, and importance of the missing information to understanding vehicle emissions, assessing compliance, and facilitating recalls and other remediation. Penalties were assessed for each separate engine family for which there are recordkeeping violations.



based penalty. A large penalty for these two violations is justified because reporting requirements are critical to the integrity and success of EPA's vehicle and engine certification program. Proper reporting facilitates compliance, enables the EPA to assess compliance, and, where necessary, allows the EPA to take enforcement action and effectuate necessary remediation. On the other hand, AED sees risk in an action for civil penalties for more than \$67,000 here because ACAT took timely steps to effectuate an appropriate technical resolution to the defects and the defects caused no known excess emissions. On the facts of this case, \$67,000 is reasonable, especially in light of the CAA's authorization of \$32,500 per day of violation. CAA §§ 203(a)(2)(A), 205(a), 208(a), 42 U.S.C. §§ 7522(a)(1)(A), 7524(a), 7542(a); 40 C.F.R. §§ 19.4, 1068.101(a)(2).

#### *Preliminary Deterrence Amount*

Here, the preliminary deterrence amount is \$1,091,252. As discussed further below, the economic benefit portion of this amount is \$14,000, and the gravity component is \$1,077,252.

##### *A. Economic Benefit*

The economic benefit portion of the penalty was calculated to be \$14,000, based on the avoided cost to test the four engine families for which Respondent changed the ECM map from the map in the vehicle Respondent tested in support of its COC applications. We determined that cost to be \$3,500 per engine family.

##### *B. Gravity*

The gravity component of the preliminary deterrence amount in this case is \$1,077,252. This is the sum of: (i) \$982,252, which is the multiple-vehicle/engine gravity as adjusted for the scaling factors in the Penalty Policy that reflect the total number of vehicles at issue (29,189); and (2) the penalty adjustment for Respondent's business size (\$95,000).

The Penalty Policy requires calculation of the per-engine base penalty based on engine size in horsepower (HP). The base per-vehicle penalty is \$1,920 for the 66 HP engines, \$1,300 for the 35 HP engines, and \$400 for the 5 HP engines, based on the values from Table 1 of the Penalty Policy. See Penalty Policy at 16. The Penalty Policy next adjusts the per-vehicle base penalty to reflect the egregiousness of the violation. The per-vehicle base penalty has been multiplied by 3.25 to reflect the moderate egregiousness of the violation, yielding a per-engine base penalty of \$6,240, \$4,225, and \$1,300, respectively. Violations involving the manufacture, sale, or offer for sale of uncertified vehicles fall under the "moderate" category of egregiousness if the engines are likely to emit similar emissions to certified engines, as described in the Penalty Policy. See Penalty Policy at 13.

Through application of the scaling factors, the adjusted per-vehicle base penalty is multiplied by 1.0 for the first ten vehicles; 0.2 for the next 90 vehicles; 0.04 for the next 900 vehicles; 0.008 for the next 9,000 vehicles; and 0.0016 for the next 90,000 vehicles. See Penalty Policy at 17-18. These values are added together to arrive at the final base penalty for the total number of vehicles at issue (29,198). The application of the scaling factors yields a penalty of \$982,252.

The Penalty Policy specifies that the gravity component be adjusted to reflect the violator's size based on net worth or some other basis. See Penalty Policy at 20. AED increased the gravity component by \$95,000, which is based on an estimated business size of \$100,000,000. This is based on the company's 2014 Federal Tax Returns. See Penalty Policy at 21.



### *Initial Penalty Target Figure*

Under the Penalty Policy, the initial penalty target figure is the preliminary deterrence amount (\$1,077,252 (gravity) + \$14,000 (economic benefit) = \$1,091,252), of which the gravity component is adjusted to reflect the violator's degree of willfulness or negligence, degree of cooperation or non-cooperation, and history of noncompliance. See Penalty Policy at 23.

First, AED determined that a 10% (\$107,725) downward adjustment to the gravity component of the penalty was warranted to account for the Respondent's cooperation in this case. Respondent conducted an internal investigation, provided written reports and extensive documentation regarding the alleged violations, and extended tolling agreements.

Second, AED determined that a 15% (\$161,588) downward adjustment to the gravity component of the penalty was warranted to account for the Respondent's lack of willfulness. Most notably, Respondent did not willfully conceal the AECDs, but simply did not report them. Once disclosed, the EPA approved the AECDs for subsequent model years. Also, although Respondent changed the maps in the vehicles it produced and sold from the maps used in the vehicles it tested in support of its COC applications, these changes did not increase emissions and showed no willful disregard for certification requirements. In both cases, Respondent represents that it failed to disclose these emission control design features based on a misunderstanding of the legal requirements.

These two downward adjustments yield an initial penalty target figure of \$821,939.

### *Final Penalty Amount*

Under the Penalty Policy, the penalty can be adjusted to account for litigation risk and other unique factors. AED decreased the initial penalty target figure by just over 31 percent for litigation risk. This is AED's assessment of the risk we face in an action for civil penalties on the facts of this case. Most notably, according to ACAT, it employed the AECDs as standard components of an electronic fuel injection system to address variations in atmospheric conditions, engine temperature, fuel quality, and drivability under all conditions. Once ACAT disclosed these AECDs, the EPA approved them for use in subsequent model years. In spite of the regulations mandating otherwise, ACAT erroneously believed that the EPA did not require manufacturers to report such AECDs in their applications for certification of an engine family and believed that it provided sufficient information for the EPA to evaluate the appropriateness of the design. Due to the nature of the violations and lack of any excess emissions, a judge may be reluctant to award a much larger penalty. With this reduction for litigation risk, the initial penalty target figure is reduced by \$336,939. The final penalty for the certification violations, therefore, is \$485,000. Adding the \$67,000 penalty for the reporting violations yields the penalty agreed to by the parties and included in the CAFO, \$552,000.

Payment is due within six months, and a payment of \$100,000 is due within 30 days. This reflects that Respondent demonstrated that its cash flow is presently irregular and constrained. This delayed payment schedule is consistent with EPA's Guidance on Evaluating a Violator's Ability to Pay a Civil Penalty in an Administrative Enforcement Action (June 29, 2015), page 15. *See* Attachment B, Respondent's Financial Certification.



## Release

As specified in the Consent Agreement, completion of the terms of the Consent Agreement will resolve Respondents' liability for federal civil penalties for the violations and facts alleged in the Consent Agreement. See proposed CAFO ¶ 37.

## Environmental Appeals Board Jurisdiction

The Environmental Appeals Board is authorized to ratify consent orders memorializing settlements between the EPA and Respondents resulting from administrative enforcement actions under the CAA, and to issue final orders assessing penalties under the CAA. See EPA Delegation 7-41-C; 40 C.F.R. § 22.4(a)(1).

## Human Health and Environmental Concerns Presented by Respondent's Actions

We do not believe that the violations resulted in any environmental harm. However, this case is necessary to protect the integrity of the EPA's vehicle certification program, which is designed to reduce emissions of harmful air pollution from vehicles. It is essential that manufacturers disclose all AECDs in their vehicles and all changes to ECM maps so the EPA may review these emission control strategies. Here, Respondent failed to afford the EPA this opportunity before selling thousands of vehicles to the public. Likewise, emission defect reports ensure that the EPA learns of any problems with the emission control systems of vehicles after they are sold. This affords the EPA the opportunity to work with the manufacturer to develop any solution, and for the EPA to consider exercising its authority to recall vehicles. Here, Respondent failed to timely notify the EPA of emissions-related defects.

## The CAFO Would Serve the Public Interest

The CAFO serves the public interest because it contains specific, appropriate relief that is technically adequate to accomplish the goals of the Clean Air Act to protect the nation's air quality and enhance the productive capacity of its population. See 42 U.S.C. § 7401(b)(1); proposed CAFO ¶ 45.

This CAFO recoups Respondent's economic benefit of noncompliance, thereby remedying the unfair economic advantage gained over competitors. The penalty will also specifically deter Respondent, and generally deter others in the industry from committing similar violations in the future.

## EPA Delegations of Authority and Administrative Penalty Waiver

Phillip A. Brooks, Director of AED, is authorized to sign the CAFO on the EPA's behalf. Congress delegated to the EPA Administrator the authority to administratively assess civil penalties in lieu of a civil judicial action in matters involving penalties under \$320,000 "unless the Administrator and the Attorney General jointly determine that a matter involving a larger penalty amount is appropriate for administrative penalty assessment." CAA § 205(c)(1), 42 U.S.C. § 7524(c)(1), 40 C.F.R. §§ 19.4, 1068.125(b); see 40 C.F.R. § 1068.101(h) (defining a violation of 40 C.F.R. § 1068.101(a) as being a violation of CAA §§ 203 and 213(d), 42 U.S.C. §§ 7522 and 7547(d), for which the administrative penalty cap has been adjusted for inflation). EPA obtained a waiver of the civil penalty cap from the United States Department of Justice on March 31, 2015. See Attachment C, A copy of the DOJ Waiver.

The Administrator delegated the authority "to sign consent agreements memorializing settlements between the Agency and respondents" and to "represent the EPA in administrative proceedings conducted

under the CAA and to negotiate consent agreements between the Agency and respondents resulting from such enforcement actions” to the Assistant Administrator for the Office of Enforcement and Compliance Assurance (OECA AA). EPA Delegation 7-6-A; Delegation 7-6-B. The OECA AA redelegated these authorities to the Division Director level. Office of Enforcement and Compliance Assurance Redelegation 7-6-A (March 5, 2013); Office of Civil Enforcement Redelegation 7-6-A (March 5, 2013). Thus, Phillip A. Brooks, Director of the AED, is authorized to sign a CAFO on the EPA’s behalf.

Recommendation

I respectfully recommend that you ratify the Consent Agreement and issue the proposed Final Order. Please direct any questions to Phillip A. Brooks at (202) 564-0652 or Jocelyn L. Adair at (202) 564-1011.

Attachments:

- A. Consent Agreement and Proposed Final Order
- B. Respondent’s Financial Certification
- C. DOJ Waiver under section 205(c) of the Act, 42 U.S.C. § 7524(c)

cc: Robert Wyman, Counsel for Respondent





## Supplemental Statement to Statement of Financial Condition

July 28, 2016

Arctic Cat Inc., a company incorporated and existing under the laws of United States of America and Minnesota, having its principal place of business at 505 Highway 169 North, Suite 1000, Plymouth, Minnesota 55441 (hereinafter referred to as "ARCTIC CAT") provides this additional supplemental financial information (Supplemental Statement) to its July 19, 2016 Statement of Financial Condition in support of a claim regarding ability-to-pay (ATP) in the matter of settlement with the United States Environmental Protection Agency ("EPA") outlined in the Environmental Appeals Board Docket No. CAA-HQ-2016-7854.

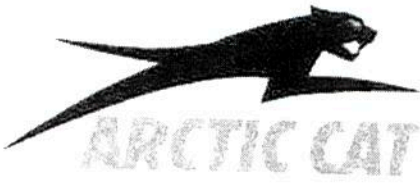
### Confidentiality Requested

This Supplemental Statement and related communications contain non-public, material Confidential Business Information (CBI). ARCTIC CAT requests confidentiality in all aspects related to this document.

### Supplemental Information

As a supplement to ARCTIC CAT'S July 19, 2016 Statement of Financial Condition, ARCTIC CAT points EPA to its July 29, 2016 Earnings Report for the Fiscal Quarter Ending June 2016 and states the following. As of July 28, 2016:

- Arctic Cat has approximately \$62 million USD outstanding on its ABL credit facility;
- On July 29, 2016, Arctic Cat will announce that it lost approximately \$10-11 million USD in its first fiscal quarter, after losing \$17 million in Arctic Cat's prior fiscal quarter;
- At this time, (and with the exception of funds put into our account that are borrowed from our credit line, to cover outstanding checks) Arctic Cat has approximately \$0 USD in cash in the USA;
- Arctic Cat expects its outstanding borrowings to increase to over \$100 million USD in the course of the next few months.
- Despite the above, Arctic Cat expects its financial situation will improve markedly toward the end of the calendar year, with further improvements anticipated by the end of our fiscal year, which ends on March 31, 2017.



Certification Statement

I certify, under penalty of law, that the information contained in this Supplemental Statement and Arctic Cat's July 19, 2016 Statement of Financial Condition and the accompanying documents, are true, accurate, and complete based upon my personal knowledge or my personal inquiry of the person or persons directly responsible for gathering the information, and I am aware that there are significant penalties for submitting false information, including the possibility of fines and imprisonment for knowing violations.

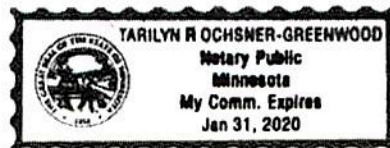
X

Christopher J. Eperjesy  
Chief Financial Officer

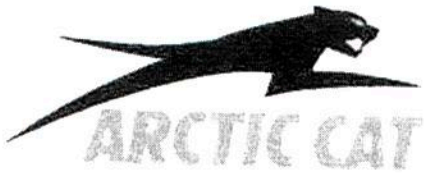
Sworn to and subscribed before me on the 29 day of July, 2016.

X

Notary Public







## Statement of Financial Condition

July 19, 2016

Arctic Cat Inc., a company incorporated and existing under the laws of United States of America and Minnesota, having its principal place of business at 505 Highway 169 North, Suite 1000, Plymouth, Minnesota 55441, United States of America (hereinafter referred to as "ARCTIC CAT") provides this Statement of Financial Condition in support of a claim regarding ability-to-pay (ATP) in the matter of settlement with the United States Environmental Protection Agency ("EPA") outlined in the Environmental Appeals Board Docket No. CAA-HQ-2016-7854.

### Confidentiality Requested

ARCTIC CAT requests confidentiality in all aspects related to this document, its attachments, and EPA determination of ATP. This document, attachments and related communications contain Confidential Business Information (CBI).

### Background

The EPA and ARCTIC CAT are entering into a settlement agreement with terms that include payment from ARCTIC CAT to EPA a sum of \$552,000 as a civil penalty.

ARCTIC CAT is a publicly traded, USA manufacturer of recreational off-road vehicles based in the Midwest, directly employing approximately 1,500 skilled employees, with engineering and production facilities based in Minnesota and a distribution facility in Ohio. ARCTIC CAT products are sold through a network of dealerships across the USA that employ approximately 6,432 additional skilled workers. ARCTIC CAT has struggled with difficult macroeconomic and challenging environmental trends since 2014, including unfavorable weather conditions (particularly due to the lack of snowfall in key geographies) and a decrease in consumer discretionary spending which, coupled with a highly-competitive market, has led to a decline in sales and a resulting decrease in operating cash flow. In addition, ARCTIC CAT has spent and continues to spend a significant amount of cash in patent litigation.

ARCTIC CAT does not have any outstanding taxes nor other monetary debt to any governmental agency. The company takes pride in its Midwestern culture and business practices.

### Claim of Ability-to-Pay

ARCTIC CAT does not have the cash in hand to pay the full settlement amount in 30 days. ARCTIC CAT incurred a net loss in fiscal year 2016 following a steep decline in profitability in fiscal year 2015. The company expects another challenging year and projects a net loss in fiscal year 2017 (our current fiscal



year). The negative earnings trends of the past few years have reduced ARCTIC CAT's operating cash flows and cash position.

#### **Impact of Civil Penalty to ARCTIC CAT**

ARCTIC CAT is under new management and attempting a turn-around with product innovation, investment in new talent and investment in facility improvements. Payment of the settlement in full in 30 days could severely impact these efforts by forcing a hiring and spending freeze, halting critical new projects and delaying facility improvements. Full payment would impact ARCTIC CAT's ability to invest current cash flow into developing new products that are vital to ensuring we maintain a strong dealer and customer base. It would hamper process improvements and the company's ability to defend its patents in the competitive market.

ARCTIC CAT expects to require funds in the next three years to turn around the company's financial situation towards profitability. This entails hiring talent to improve processes and innovate new products, investing in engineering and production and testing facilities, developing new engine technology to meet future regulatory requirements, defending intellectual property, manufacturing inventory, supporting dealers, and investigating new product markets for continuing growth.

ARCTIC CAT has made recent investments in more environmentally sustainable technology, including converting to a non-phosphate pre-treatment chemical system in a new paint line. In addition, ARCTIC CAT plans to invest in new technology to improve environmental controls in its product lines over the next three years. This includes meeting new California regulation regarding evaporative emissions and pursuing improvements and reductions in existing products. The settlement would hamper these investments.

Due to insufficient funds, ARCTIC CAT would need to borrow monies to pay the settlement in full within 30 days. This would impact credit and the ability to borrow other funds in support of ongoing business and investments related to improvements necessary for the company's turnaround efforts.

#### **Request for Extended Payment in Installments**

ARCTIC CAT requests consideration per EPA Memorandum "*Guidance on Evaluating a Violator's Ability to Pay Civil Penalty in an Administrative Enforcement Action*" in relation to burden imposed upon ARCTIC CAT from the aforementioned settlement agreement. This document and attachments are provided as burden of proof that full payment of the settlement amount within a short period of time will cause ARCTIC CAT undue financial hardship and prevent it from paying (or at least delay payment of) its ordinary and necessary business expenses.

ARCTIC CAT requests that payment made be over 3 years to allow the company to generate adequate income to pay the full amount while maintaining efforts to execute its turnaround plan and improve its





financial condition. Specifically, ARCTIC CAT proposes an initial payment within 30 days of \$55,200 and monthly payments of \$14,491.37 over 36 months to liquidate the debt in its entirety. The monthly payments include an interest rate of 3.2% to cover potential changes in the valuation of money during the payment period.

#### Proposed Payment Schedule:

#### PROPOSED PAYMENT SCHEDULE

##### PAYMENT SUMMARY

Settlement total	\$552,000.00
Downpayment percentage	10.00%
Downpayment total	\$55,200.00
Scheduled total amount	\$496,800.00
Annual interest rate	3.20%
Payment period in years	3
Number of payments per year	12
Start date of payments	10/1/2016

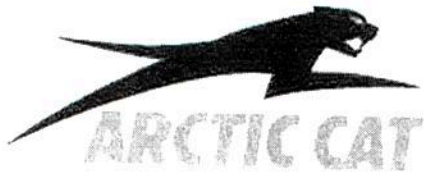
Optional extra payments: \$

##### SCHEDULE SUMMARY

Scheduled payment	\$14,491.37
Scheduled number of payments	36
Actual number of payments	36
Total early payments	\$55,200.00
Total interest	\$24,889.48

Payer: Arctic Cat Inc.  
Payee: U.S. EPA

DATE	PAID	BEGINNING BALANCE	SCHEDULED PAYMENT	EXTRA PAYMENT	TOTAL PAYMENT	PRINCIPAL	INTEREST	ENDING BALANCE	CUMULATIVE INTEREST
1	10/1/2016	\$496,800.00	\$14,491.37	\$0.00	\$14,491.37	\$13,166.57	\$1,324.80	\$483,633.43	\$1,324.80
2	11/1/2016	\$483,633.43	\$14,491.37	\$0.00	\$14,491.37	\$13,201.69	\$1,289.69	\$470,431.74	\$2,614.49
3	12/1/2016	\$470,431.74	\$14,491.37	\$0.00	\$14,491.37	\$13,236.89	\$1,254.48	\$457,194.85	\$3,868.97
4	1/1/2017	\$457,194.85	\$14,491.37	\$0.00	\$14,491.37	\$13,272.19	\$1,219.19	\$443,922.66	\$5,088.16
5	2/1/2017	\$443,922.66	\$14,491.37	\$0.00	\$14,491.37	\$13,307.58	\$1,183.79	\$430,615.08	\$6,271.95
6	3/1/2017	\$430,615.08	\$14,491.37	\$0.00	\$14,491.37	\$13,343.07	\$1,148.31	\$417,272.01	\$7,420.26
7	4/1/2017	\$417,272.01	\$14,491.37	\$0.00	\$14,491.37	\$13,378.65	\$1,112.73	\$403,893.36	\$8,532.99
8	5/1/2017	\$403,893.36	\$14,491.37	\$0.00	\$14,491.37	\$13,414.33	\$1,077.05	\$390,479.04	\$9,610.04
9	6/1/2017	\$390,479.04	\$14,491.37	\$0.00	\$14,491.37	\$13,450.10	\$1,041.28	\$377,028.94	\$10,651.31
10	7/1/2017	\$377,028.94	\$14,491.37	\$0.00	\$14,491.37	\$13,485.96	\$1,005.41	\$363,542.98	\$11,656.72
11	8/1/2017	\$363,542.98	\$14,491.37	\$0.00	\$14,491.37	\$13,521.93	\$969.45	\$350,021.05	\$12,626.17
12	9/1/2017	\$350,021.05	\$14,491.37	\$0.00	\$14,491.37	\$13,557.99	\$933.39	\$336,463.07	\$13,559.56
13	10/1/2017	\$336,463.07	\$14,491.37	\$0.00	\$14,491.37	\$13,594.14	\$897.23	\$322,868.93	\$14,456.80
14	11/1/2017	\$322,868.93	\$14,491.37	\$0.00	\$14,491.37	\$13,630.39	\$860.98	\$309,238.54	\$15,317.78
15	12/1/2017	\$309,238.54	\$14,491.37	\$0.00	\$14,491.37	\$13,666.74	\$824.64	\$295,571.80	\$16,142.42
16	1/1/2018	\$295,571.80	\$14,491.37	\$0.00	\$14,491.37	\$13,703.18	\$788.19	\$281,868.61	\$16,930.61
17	2/1/2018	\$281,868.61	\$14,491.37	\$0.00	\$14,491.37	\$13,739.72	\$751.65	\$268,128.89	\$17,682.26
18	3/1/2018	\$268,128.89	\$14,491.37	\$0.00	\$14,491.37	\$13,776.36	\$715.01	\$254,352.53	\$18,397.27
19	4/1/2018	\$254,352.53	\$14,491.37	\$0.00	\$14,491.37	\$13,813.10	\$678.27	\$240,539.42	\$19,075.54
20	5/1/2018	\$240,539.42	\$14,491.37	\$0.00	\$14,491.37	\$13,849.94	\$641.44	\$226,689.49	\$19,716.98
21	6/1/2018	\$226,689.49	\$14,491.37	\$0.00	\$14,491.37	\$13,886.87	\$604.51	\$212,802.62	\$20,321.48
22	7/1/2018	\$212,802.62	\$14,491.37	\$0.00	\$14,491.37	\$13,923.90	\$567.47	\$198,878.72	\$20,888.96
23	8/1/2018	\$198,878.72	\$14,491.37	\$0.00	\$14,491.37	\$13,961.03	\$530.34	\$184,917.69	\$21,419.30
24	9/1/2018	\$184,917.69	\$14,491.37	\$0.00	\$14,491.37	\$13,998.26	\$493.11	\$170,919.43	\$21,912.41
25	10/1/2018	\$170,919.43	\$14,491.37	\$0.00	\$14,491.37	\$14,035.59	\$455.79	\$156,883.84	\$22,368.20
26	11/1/2018	\$156,883.84	\$14,491.37	\$0.00	\$14,491.37	\$14,073.02	\$418.36	\$142,810.82	\$22,786.56
27	12/1/2018	\$142,810.82	\$14,491.37	\$0.00	\$14,491.37	\$14,110.55	\$380.83	\$128,700.27	\$23,167.39
28	1/1/2019	\$128,700.27	\$14,491.37	\$0.00	\$14,491.37	\$14,148.17	\$343.20	\$114,552.10	\$23,510.59
29	2/1/2019	\$114,552.10	\$14,491.37	\$0.00	\$14,491.37	\$14,185.90	\$305.47	\$100,366.20	\$23,816.06
30	3/1/2019	\$100,366.20	\$14,491.37	\$0.00	\$14,491.37	\$14,223.73	\$267.64	\$86,142.47	\$24,083.70
31	4/1/2019	\$86,142.47	\$14,491.37	\$0.00	\$14,491.37	\$14,261.66	\$229.71	\$71,880.81	\$24,313.41
32	5/1/2019	\$71,880.81	\$14,491.37	\$0.00	\$14,491.37	\$14,299.69	\$191.68	\$57,581.11	\$24,505.10
33	6/1/2019	\$57,581.11	\$14,491.37	\$0.00	\$14,491.37	\$14,337.82	\$153.55	\$43,243.29	\$24,658.65
34	7/1/2019	\$43,243.29	\$14,491.37	\$0.00	\$14,491.37	\$14,376.06	\$115.32	\$28,867.23	\$24,773.96
35	8/1/2019	\$28,867.23	\$14,491.37	\$0.00	\$14,491.37	\$14,414.40	\$76.98	\$14,452.83	\$24,850.94
36	9/1/2019	\$14,452.83	\$14,491.37	\$0.00	\$14,452.83	\$14,414.29	\$38.54	\$0.00	\$24,889.48



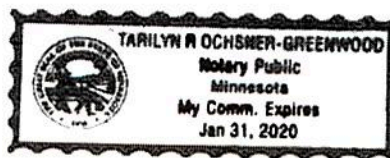
X

Christopher J. Eperjesy  
Chief Financial Officer

Sworn to and subscribed before me on the 19 day of July, 2016.

X

Notary Public



**References:**

<https://www.epa.gov/sites/production/files/2015-06/documents/atp-penalty-evaluate-2015.pdf>



# Arctic Cat Consolidated Balance Sheets

Table of Contents

**ARCTIC CAT INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(\$ in thousands, except per share amounts)

	March 31,	
	2016	2015
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 17,730	\$ 40,253
Short-term investments	—	1,009
Accounts receivable, less allowances	35,760	25,067
Inventories	140,007	152,443
Prepaid expenses	6,456	5,363
Income taxes receivable	11,765	5,151
Deferred income taxes	17,229	13,050
Other current assets	100	3,628
Total current assets	229,047	245,964
Property and equipment		
Machinery, equipment and tooling	214,372	194,074
Land, buildings and improvements	33,259	30,004
	247,631	224,078
Less accumulated depreciation	166,144	161,210
Goodwill	81,487	62,868
Intangible assets, net	3,342	3,342
Other assets	2,855	3,237
	1,163	—
	<u>\$317,894</u>	<u>\$315,411</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable		
Accrued expenses:	\$ 72,012	\$ 70,257
Marketing		
Compensation	9,087	14,495
Warranties	5,634	4,429
Insurance	24,809	23,062
Other	3,538	4,383
Total current liabilities	8,950	5,463
Deferred income taxes	124,030	122,089
Other liabilities	13,193	9,716
Commitments and contingencies	13,280	3,234
	—	—
Shareholders' equity		
Preferred stock, par value \$1.00; 2,050,000 shares authorized; none issued	—	—
Preferred stock—Series B Junior Participating, par value \$1.00; 450,000 shares authorized; none issued	—	—
Common stock, par value \$.01; 37,440,000 shares authorized; shares issued and outstanding: 13,038,249 at March 31, 2016 and 12,949,702 at March 31, 2015	—	—
Additional paid-in-capital	130	130
Accumulated other comprehensive loss	6,105	1,940
Retained earnings	(10,184)	(7,142)
Total shareholders' equity	171,340	185,444
	<u>167,391</u>	<u>180,372</u>
	<u>\$317,894</u>	<u>\$315,411</u>

The accompanying notes are an integral part of these consolidated financial statements.





U.S. Department of Justice

Environment and Natural Resources Division

Environmental Enforcement Section  
P.O. Box 7611  
Washington, DC 20044-7611

Tel: (202) 514-4084  
karen.dworkin@usdoj.gov

March 31, 2015

Phillip A. Brooks, Director  
Air Enforcement Division  
Office of Enforcement and Compliance Assurance  
Environmental Protection Agency  
1200 Pennsylvania Avenue, N.W.  
Washington, D.C. 20460

Re: Request Pursuant to Section 205(c) of the Clean Air Act for a Waiver of the Penalty Limitation on EPA's Authority to Initiate Administrative Action Against Arctic Cat, Inc.

Dear Phill:

This is in response to your letter dated February 4, 2015, requesting a waiver to pursue administrative action against Arctic Cat, Inc. in connection with the manufacture and sale of highway motorcycles and recreational in violation of the certification requirements of the Act and implementing regulations. I concur with your request for a waiver pursuant to Section 205(c) of the Clean Air Act (CAA), 42 U.S.C. § 7524(c), of the limitation on EPA's authority to assess administrative penalties, in order to pursue administrative action in this matter.

If you have any questions, please call me or Leslie Allen.

Sincerely,

  
Karen S. Dworkin

Assistant Section Chief  
Environmental Enforcement Section